National Commission on Energy Policy

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Good morning Chairman Boucher and Members of the Subcommittee. I speak to you today on behalf of the National Commission on Energy Policy. The Commission is a project of the Bipartisan Policy Center, a new organization dedicated to advancing bipartisan solutions to some of our nation's most urgent challenges.

Certainly energy and climate change are among the foremost of these challenges and I commend this Subcommittee, the Committee on Energy and Commerce, and especially Chairmen Dingell and Boucher, for the thoughtful consideration they are giving these issues and for the good work the Committee has already been done in developing white papers and holding hearings.

Before discussing the various legislative proposals that are the subject of today's hearing, I'd like to say a little more about the National Commission on Energy Policy and the Bipartisan Policy Center (BPC). The Commission was launched in 2002. It brings together a politically and professionally diverse group of 21 nationally recognized energy experts. In 2004, the Commission released its first report, calling for a comprehensive, bipartisan strategy to meet our nation's energy challenges. Since then we have continued to meet, undertake new analyses, and help inform the national debate over these critical issues. We issued a subsequent report, with updated recommendations, in April 2007 and continue to work closely with members of Congress on both sides of the aisle to develop effective climate and energy policies.

The Energy Commission's success forging a principled bipartisan compromise inspired the founding of the Bipartisan Policy Center. Launched in 2007, the BPC has projects underway that address a broad suite of issues in addition to energy, including national security, agriculture, health care, and transportation. The BPC's mission is to develop and promote solutions that can attract the public support and political momentum to achieve real progress. Real progress is just what we need on climate change. Real progress will require a long-term transformation of our energy systems. We need to get started on that transformation, not only because the climate risks we incur by continued delay are unacceptable, but because the energy status quo isn't working very well. Congress passed major energy legislation in 2005 and 2007 and we've made progress in some important areas—notably boosting automobile fuel economy, energy efficiency standards, and renewable energy technologies. Still, to most experts and certainly to most American citizens our energy future seems far from secure.

All the bills the Subcommittee is considering today, by requiring significant greenhouse gas reductions and providing incentives for new technologies, seek to make a decisive course correction in our current energy trajectory. Their specifics certainly vary. H.R. 1590 and H.R. 6186, the Waxman and Markey bills respectively, set the most ambitious emission reduction targets (on the order of 80 percent below current levels by mid-century). S.1766, S. 2191, and S. 3036—the Bingaman/Specter, Lieberman/Warner, and Boxer bills, respectively call for reductions on the order of 60–70 percent below current emissions levels by 2050.

Given the difficulty of charting public policy on *any* issue over a four-decade timeframe, I would argue that one probably should not make too much of these differences in long term targets. Rather the more important questions are: How do these bills address the myriad and sometimes competing concerns that inevitably arise when contemplating mandatory limits on greenhouse gas emissions? How well do various program designs balance the different interests of consumers, businesses, investors, and the environment? How effective will they be in accelerating the development and deployment of a next generation of energy technologies? And perhaps most important of all: what is the combination of trade-offs that will make it possible for a bill to garner the

bipartisan support needed to become law and get a greenhouse-gas reduction program started.

As a starting point, it's useful to look over where we've been and how far we've come in grappling with the climate issue. Certainly our collective sense of urgency has grown, spurred in part by mounting evidence on the scientific front. New stakeholders have joined the call for action including labor unions, evangelical Christians, sportsmen, Latino and African American organizations, farmers, national security experts and a wide variety of energy producers, manufacturers and business groups.

The depth and seriousness of the proposals we are discussing today is itself testimony to how far this debate has progressed. Especially promising, from the standpoint of passing legislation, are the multiple points of commonality in all of these bills. First, all propose to implement reductions via a market-based, cap-and-trade regime. Even the Waxman bill (H.R. 1590), which sets broad targets but leaves most implementation details to EPA, points to a presumption that cap and trade would be the approach used. There is convergence on a number of other key points as well. For example, each of these bills (with the exception, in some cases, of H.R. 1590[1]) includes provisions for:

- an economy-wide program that primarily regulates "upstream" emissions sources (e.g., petroleum producers/importers; natural gas pipelines/distributors; large coal users/industrial facilities)
- containing program costs via mechanisms like banking, borrowing, and offsets (i.e., emissions credits for reductions achieved outside the cap and in other countries)
- auctioning a far larger share of allowances than has been typical in past cap-and-trade programs (like the U.S. Acid Rain Program) and using some of the proceeds to address impacts on consumers, including low-income households
- increasing public investment in the development and deployment of new, climate-friendly energy technologies

[1] H.R. 1590 is simply silent on a number of these issues.

- encouraging major trading partners to commit to similar emission reductions and other mechanisms to address the competitiveness concerns of U.S. industry

In sum, these bills contain the broad outline of a legislative compromise. But as usual, the devil is in the details. The remainder of my testimony focuses on four specific areas that are especially contentious—and especially important in terms of advancing viable legislation. These issues – that the Committee has identified in its thoughtful white papers – include cost containment, allowance allocation and revenue recycling, international issues (including both the treatment of offsets and competitiveness concerns), and state/federal roles.

Cost containment: Cost has always been a central issue in the debate over whether and how to limit greenhouse gas emissions. If everyone agreed that achieving reductions was cheap, we'd have a program in place by now. Instead, cost debates usually bog down in fruitless disagreements over who is making the right assumptions about technology, fuel prices, and other factors. Different assumptions can produce wildly different estimates of economic impact. Finally, even if long-term costs prove, on average, no higher than expected, there is a concern that greenhouse gas allowance markets could suffer from short-term liquidity problems and excessive volatility—producing potentially harmful price spikes. All of these cost-related concerns will be even more acute in the current environment of high and rising energy prices. That is why the Commission believes it is essential to include an explicit cost-containment mechanism as part of a cap-and-trade program. Ideally, that mechanism should be both transparent and predictable.

The Commission has recommended one option that meets those criteria: a safety valve—essentially, a cap on the price of emissions allowances—that has the effect of assuring that the per-ton cost of emissions reductions required under the program cannot rise above a known level. The safety valve or price cap would increase at a known rate over time so as to deliver steadily stronger incentives for mitigation over time while simultaneously providing planning certainty for industries, such as electric utilities, that must make large capital investments in energy technology. We have argued that such a

safety valve should be phased out when the need for environmental certainty outweighs the need for cost certainty and significant progress has occurred at the international level.

We are aware that some find the safety valve approach unacceptable because it risks foregoing emission reductions if costs prove higher than expected (that is, it allows for the possibility that actual emissions will exceed the cap). We are also aware that other measures included in the bills we are discussing today are part of the overall answer to cost concerns. Many of these mechanisms—examples include banking and borrowing; emission offsets; and a more recent idea, first introduced in the Lieberman-Warner bill, that involves creating a Federal Reserve-like entity to oversee carbon markets—can help to ensure that the market for allowances is sufficiently liquid and does not suffer from excessive price volatility. None of these options, however, provide the certainty or predictability of a safety valve. And as such, they may not be "enough" to decisively answer concerns about the potential economic impact of carbon regulation on consumers and households. Given the importance of these concerns, the Commission—while still supportive of a safety valve—believes that other cost-containment options and compromises should be explored.

Allowance allocation and revenue recycling: Closely related to the issue of cost is concern about the impact of higher energy prices on consumers, especially low-income households, and businesses. Revenue recycling—that is, taking some of the revenues raised by auctioning emission allowances and returning those revenues to consumers via the tax code, direct rebates, assistance programs, or other mechanisms—provides a means of addressing consumer and low-income concerns without reducing the effectiveness of the cap-and-trade program in terms of creating market signals for emissions reductions.

Moreover, economic modeling indicates that auctioning allowances and recycling the revenues is generally more "efficient"—in the sense that it reduces the net cost to society of implementing the program—than giving allowances away. Depending on how revenues are recycled (the economics literature tends to favor using auction revenues to reduce taxes on income and investment), this approach can generate economic benefits that offset some of the costs incurred to reduce emissions.

As I have already noted, all of the major proposals under discussion today provide for a much larger auction than has been typical of past cap-and-trade programs and use the resulting revenues to address a number of other important policy objectives. The Markey bill (H.R. 6186) directs over half of auction proceeds to low- and middle-income households via a combination of rebates and tax credits. The Senate bills (S. 1766, S. 2191, and S. 3036) allocate a share of allowances (9–11 percent) directly to states for redistribution as the states see fit.[2] All of the bills also allocate some share of allowances (or auction revenues) to other programs or for other purposes, including technology development, adaptation assistance, energy-intensive industries, and agricultural and forest carbon sequestration.

Exactly who gets what share of the allocation pie is likely to remain very contentious, as the stakes are high—the potential allowance value created by an economy-wide program is on the order of tens of billions of dollars per year. The recent Senate debate suggests the need for a closer focus on the fiscal implications of greenhouse-gas emissions reduction programs. Given the importance of these issues and the magnitude of the potential revenue streams involved, the Commission believes that would be entirely appropriate. Our general view is that arguments for auctioning some portion of the allowances and for emphasizing the positive gains achievable through thoughtful revenue recycling are stronger than ever, in the current economic and political context. The Commission has long recommended that allocation decisions should be guided by equity considerations, should seek to maximize benefits to society as a whole, and should protect low-income households. These remain, in our view, the right priorities.

International participation, offsets, and U.S. competitiveness: Clearly, domestic efforts to limit greenhouse gas emissions will not occur in a vacuum. Action by other nations is not only desirable but ultimately essential—not only because the problem of climate change will inevitably require a global response, but because concern about adverse

[2] In addition, S. 1766 directs auction revenues from a 4 percent share of allowances specifically to low-income assistance programs.

impacts on U.S. competitiveness will continue to arise as long as our major trading partners (including especially major developing countries like China and India) are not undertaking similar action to reduce carbon emissions. The Senate bills provide for countervailing trade measures if major trading partners fail to act within some reasonable timeframe. Defining those measures with greater specificity such that they both address the legitimate concerns of energy-intensive U.S. industries and do not run afoul of international trade rules and agreements will be a challenge. Current legislative proposals also provide positive inducements for participation by other nations (such as funding for technology transfer and forestry projects overseas). The Commission strongly believes that a balance of carrots and sticks is the most effective approach to engage our major trading partners.

Emissions offsets present another aspect of program design with important international dimensions. By allowing American companies to take advantage of low-cost emission reductions or carbon sequestration opportunities in other countries, offsets can enhance regulatory flexibility and significantly reduce program costs at home, while delivering other important non-climate benefits (such as forest and biodiversity protection and sustainable development) in poor countries. An offsets program must be carefully designed, however, and implemented with appropriate guidelines and verification requirements. Over-reliance on offsets—especially with inadequate safeguards to ensure that claimed emissions reductions are real, permanent, additional, and verifiable—could undermine program goals and political support, especially if substantial U.S. funds are leaving the country to support emission-reduction efforts abroad rather than at home.

State/federal roles: A number of states and regions have moved ahead of the federal government to adopt their own greenhouse gas reduction goals and regulatory requirements. Some states are concerned that a federal program could undermine their ability to pursue more ambitious targets. The best response to this concern, in the Commission's view, is to encourage state actions that are consistent with a national program but that avoid creating overlapping cap-and-trade programs with different currencies. Federal policy should provide incentives designed to recognize states leadership while also promoting continued progress in areas where states have primary

jurisdiction or have traditionally played a key role, including building codes, appliance and equipment efficiency standards, electric and natural gas utility regulation, and local clean energy development.

In sum, I come before the Subcommittee today with a message of good news and bad news. The good news is that the bills before you show that we have come a long way toward finding common ground on than environmentally and economically sound policy for tackling our nation's contribution to global warming. The bad news is that many difficult questions remain. My testimony has attempted to identify four of the issues that will be especially important in advancing the legislative debate. These issues are difficult, but we cannot allow them to paralyze us. To the extent the Commission can provide more information or help explore options for resolving some of these questions, we would welcome the opportunity to be of assistance.

In closing, I would like to address the argument that, with energy prices at record highs, this is precisely the wrong time to be doing something about climate change. The Commission disagrees. If anything our current predicament illustrates precisely the danger of drifting along with the status quo. In the long run, the policies we need to address global warming are also the policies we need to regain control of our energy destiny. And with thoughtful program designs we can be confident that benefits will be realized and the price impacts will be manageable and distributed in a manner that protects our most vulnerable citizens.

Thank you for this opportunity to testify.